

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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In the Matter of )  
Simplification of the )  
Depreciation Prescription Process )

CC Docket 92-296

OPPOSITION COMMENTS OF THE  
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

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[FCC 92-537]

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OPPOSITION COMMENTS OF THE  
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Pursuant to the Federal Communications Commission's ("FCC" or "Commission") Rules of Practice and Procedure, the National Association of Regulatory Utility Commissioners ("NARUC") respectfully submits these comments opposing petitions for reconsideration of the Federal Communications Commission's ("FCC" or "Commission") "Report and Order" ("Order") adopted September 23, 1993 and released October 20, 1993, (FCC 93-452) in the above captioned proceeding.

In support of these comments, NARUC states as follows:

I. NARUC'S INTEREST

NARUC is a quasi-governmental nonprofit organization founded in 1889. Members include the governmental bodies engaged in the regulation of carriers and utilities from all fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands. NARUC's mission is to improve the quality and effectiveness of public utility regulation in America.

Specifically, NARUC is composed of, inter alia, State and territorial officials charged with the duty of regulating the telecommunications common carriers within their respective borders. These officials have the obligation to assure that such telecommunications services and facilities as are required by the public convenience and necessity are established, and that service is furnished at rates that are just and reasonable.

Section 220(b) of the Communications Act of 1934, 47 U.S.C. Section 220 (1989), gives the FCC authority to establish depreciation rates as part of its authority to "...prescribe the forms of any and all accounts, records and memoranda subject to this chapter." Although, as a result of a 1986 Supreme Court case<sup>1</sup>, the FCC's actions in this docket cannot limit state action concerning intrastate depreciation rates, several states continue to rely, in part, on the FCC in establishing those intrastate rates. The so-called "three-way meeting process" has, for these states, been very productive.

Because of this potential impact on State commission procedures, and NARUC's stated goal of promoting more efficient regulation, NARUC has participated in all earlier phases of, and has an interest in, this proceeding.

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<sup>1</sup> Louisiana Public Service Commission v. FCC, 476 U.S. 355 (1986).

## II. BACKGROUND

The FCC currently prescribes depreciation rates for 33 Local Exchange Carriers ("LECs"), AT&T, and Alascom. On December 10, 1992, the FCC adopted a Notice of Proposed Rulemaking, 8 FCC Rcd 146 (1992), ("NPRM") seeking comment on four distinct proposals to simplify the depreciation prescription process. The NPRM also suggested changes in the treatment of future net salvage. The September 23, 1994 Order adopts two of those depreciation simplification plans.

Specifically, the Order adopts a modified form of the proposed basic factor range option ("BFRO") for the LECs regulated under the Commission's price cap regulatory scheme and a modified form of the price cap carrier option for AT&T. However, the Order does not propose any simplification schemes for Alascom or LECs currently regulated under a rate of return regulatory scheme. The Order also suggests that additional study is needed before any changes can be adopted to the current treatment of future net salvage.

The BFRO adopted for the price cap LECs is a streamlined process that requires the establishment of ranges for projection life and future net salvage factors. This process is to be implemented in phases, beginning with the accounts most readily adaptable to the range approach. Initially, the FCC proposes ranges be established for twenty-two plant categories. Ranges for remaining accounts will be proposed subsequently, if feasible.

## III. DISCUSSION

As the FCC notes in its Order at ¶ 4, mimeo at 4, for LEC depreciation simplification, the commenters were predictably divided. The state commissions, consumer groups, and MCI urged the Commission to take a measured step like the BFRO,<sup>2</sup> while the LECs urged the adoption of the price cap carrier option ("PCCO").

The PCCO, as proposed, would have allowed price cap carriers to file depreciation rates with no supporting data. After the proposed rates are filed, the FCC would issue a Public Notice seeking comment on the proposed rates, and presumably prescribe the depreciation rates based upon the "record" in the proceeding.

In early December 1993, 10 petitions for reconsideration of various aspects of the Order were filed. Not surprisingly, all were filed by LECs or by organizations representing LEC interests [e.g., the United States Telephone Association ("USTA")] with all but one asking the FCC to impose the PCCO.

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<sup>2</sup> BFRO establishes ranges for the basic factors that determine the parameters used in the depreciation rate formula, i.e., final net salvage (FNS), projection life and survivor curve [the basic factors that determine average remaining life (ARL)]. According to the FCC, this option eliminates the need for carriers to submit detailed studies in support of their proposed factors. Under this proposal, the FCC will continue to prescribe depreciation rates using the current depreciation rate formula. Carriers will apply the rates to plant account balances to determine their depreciation expense.

With the exception of Cincinnati Bell Telephone's petition,<sup>3</sup> all the other petitioners asked the FCC to reverse the adoption of BFRO and, instead, implement PCCO. In the alternative, almost all the petitioners suggest "modifications" to the BFRO which appear to move it substantially in the direction of the PCCO paradigm. The LEC arguments supporting implementation of PCCO or the modification of BFRO, with a few minor variations, have not substantially changed from those posed during the initial comment round.

Specifically, in support of adoption of PCCO, they suggest that (1) LECs have little incentive or opportunity to adjust depreciation to avoid sharing under price caps, and that (2) there is no justification for disparate treatment of price cap LECs and AT&T.

As NARUC noted in its initial comments, and as the record clearly suggests,<sup>4</sup> because it assures the most accurate results by continuing to recognize an individual carrier's accumulated depreciation reserve in setting rates, the BFRO is the most acceptable of the options posed by the FCC.

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<sup>3</sup> CBT, which does not operate under the FCC's price cap rules, limited its reconsideration request to asking the FCC to make the simplification procedures available to all LECs regardless of their regulatory classification.

<sup>4</sup> See, NARUC's April 13, 1993 Reply Comments at 3-4, suggesting that only BFRO has the necessary record support for FCC action. There, we note that, of those commenting, only 12, all LECs, supported PCCO. Twenty-one of the 24 non-LEC commenters specifically address PCCO and agree it is not an acceptable option.

PCCO is deficient as it largely discards the basic principle of matching expense to capital consumption, ignores basic life and salvage factors and is not sensitive to the depreciation reserve position of individual carriers. Moreover, PCCO should not be adopted under any form of earnings regulation because, by leaving the choice of depreciation rates to the carriers, it provides an incentive to manipulate depreciation expense - the LECs' largest single expense - to produce a desired level of earnings. As the FCC recognized in ¶ 27 of the Order, mimeo at 12, under the FCC's present price cap scheme, which clearly retains earnings regulation, there is a strong incentive for companies to either hold down depreciation expenses, if the company is earning below its authorized return, or increase them if the company is earning above or near the upper end of its authorized return. The FCC must "ensure that LECs cannot manipulate [the depreciation] mechanism to ratepayer's detriment." Id.

In response to these record arguments, the petitioners suggest that manipulation is not likely because of the strong incentive for an overall reduction in expenses engendered under price cap regulation or because manipulations "could" force higher future savings later.<sup>5</sup>

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<sup>5</sup> See, e.g., Ameritech's petition at 4-5, arguing the FCC gives too much weight to LECs' sharing obligations and "completely ignores" that the overarching incentive under price cap regulation is to decrease costs; SNET's petition at 6-7 arguing that a LEC manipulating earnings by adjusting depreciation rates would create more serious problems in that any overstatement of depreciation expense would actually force potentially higher sharing later.

Interestingly, both of these arguments concede the fact that such manipulation is possible. Moreover, both arguments completely ignore, or suggest the irrelevance of, the flexibility granted LEC decision-makers to manipulate the timing of when cost savings are realized. The ability to manipulate expense, at a minimum, allows a carrier to control when sharing with ratepayers will occur and at what level. Both arguments also implicitly suggest that regulation is static, i.e., that LECs will be under the current version of price cap regulation in perpetuity.

The LECs second argument for imposition of PCCO is that the FCC provided no explanation for its disparate treatment of AT&T and the price cap LECs in prescribing depreciation rates - and the related claim that the FCC misjudged the competitive forces impinging on LEC operations. See, e.g., Ameritech's petition at 7-8, arguing that the FCC's conclusion that price cap LECs face only "emerging competition" is an unduly restricted view of the current marketplace, and will certainly not hold true in the next few years; therefore the FCC's prescription of the BFRO for price cap LECs at a time when these LECs will be facing as much as, if not more competition than AT&T, is not justified"; BellSouth's petition at 3-4, SNET's petition at 6.



Comparison of LEC depreciation rates and regulatory schemes to those of AT&T, or other interexchange carriers ("IXC") is inappropriate. While LECs are now experiencing some growing competition, such competition exists only in limited areas of their business as compared to the extensive competition faced by the IXCs in almost every aspect of their businesses. See, e.g., Order at ¶ 21, mimeo at 10, where the FCC notes that "we believe that competitive pressures faced by AT&T in the interexchange market offer additional protection against unreasonably high prices for ratepayers."

Further, AT&T and other IXCs, which have no captive base of customers from which to extract higher depreciation charges, are investing large sums of new capital into their businesses. It does not appear that the majority of LECs are investing new capital into their systems. In fact, it appears they are generally not reinvesting all of the funds generated from current depreciation accruals.

Finally, the LEC petitions make a number of suggestions for improving the BFRO procedure. It appears that most of these suggestions are designed to modify the FCC's process so that it more closely approximates the rejected PCCO option. For the reasons stated above, NARUC respectfully contends that, to the extent the posed modifications do move the paradigm in the direction of the PCCO regulatory scheme, the LECs' suggestions also

generally lack merit.<sup>6</sup>

### III. CONCLUSION

The record supports the FCC's determination to adopt the BFRO. Accordingly, the LECs petitions suggesting either implementation of the PCCO, or modifications in BFRO to move it closer to a PCCO paradigm must be rejected. Respectfully submitted,

  
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<sup>6</sup> At least one of these LEC proposals, e.g., widening the ranges "beyond 1 standard deviation," has also been brought up by recent LEC comments filed in response to the FCC's November 12, 1993 "Order Inviting Comments" [FCC 93-492]. To the extent that that, and similar issues, have been raised by the November order, NARUC respectfully suggests that, if the FCC determines the issues merit examination at all, such examination should more appropriately occur therein. NARUC expects to address the LECs' standard deviation argument, and several others, with more specificity in its reply comments to be filed later this week.

CERTIFICATE OF SERVICE

I, JAMES BRADFORD RAMSAY, certify that a copy of the foregoing was sent by first class United States mail, postage prepaid, this 18th Day of January 1994, to all parties on the attached Service List.

  
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